TOP 5 TAKE AWAYS

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In November 2018, over 100 technical accounting and project leaders from Fortune 1000 companies along with industry experts from Big 4 audit and advisory firms met for a one-day lease accounting summit in New York City.

The experts discussed a wide variety of topics from interpreting technical accounting guidelines to practical implementation challenges. Below is a synopsis of the Top 5 Takeaways from the Lease Accounting Summit.

1

International Reporting & Working with Regional Teams

Most of the summit attendees were US-based multi-national companies that report in US GAAP as well as IFRS and local accounting standards. While most project teams have climbed the learning curve around ASC 842, there was a great deal of uncertainty amongst attendees about how best to handle local IFRS and statutory reporting post-adoption. At the time of the summit, some countries, particularly in emerging markets, had yet to formally adopt IFRS 16 or a local GAAP version.

Centralizing Leasing Processes

One of the key issues driving the complexity of international reporting is the decentralized nature of the leasing process. Each region has developed their own method for choosing which assets to lease and documenting those assets. New processes need to be established for working with local accounting teams to ensure that they collect a complete lease population from around the globe in order to meet the requirements of all applicable accounting standards.

Training Regional Teams

One major concern is a lack of knowledge about IFRS 16 amongst regional teams. The new leasing standard is complex and many of the general accounting staff in various countries have not invested sufficient time in understanding the details. Corporate accounting groups are working on educating regional directors on the standards, but for the time being are still acting as the main resource for local auditors. The consensus of the panelists was that in the first year especially, central accounting organizations need to be highly involved in the statutory audits, though some are planning to decentralize control as regional teams become more comfortable with the standards in later years.

Translating Foreign Language Leases

Another key challenge with international reporting is obtaining the necessary data to perform the calculations. Many leases are written in the local language of the country where they were signed. In these cases, central accounting and treasury organizations have found that it is useful to work with regional CFOs and accountants to translate the documents and upload the data into the lease accounting system.

2

Materiality and Accounting Policy

A second key challenge discussed at the summit related to materiality. Specifically, many attendees still had questions about what constitutes materiality. For example, some organizations are trying to determine whether their embedded leases, which are often difficult to find, are material. In addition, when companies choose not to separate lease and non-lease components for an asset class, the non-lease component could break the materiality threshold.

At most companies, the local on-site auditors are also still learning the standard and did not have all of the answers yet on how materiality should be defined, so many organizations had not yet set their thresholds.

Determining the Materiality Threshold

The first step for determining the threshold for most is attempting to get 100% of the lease population documented in a system of record. This includes even short-term leases (less than or equal to 12 months in length) which do not need to be capitalized under ASC 842. By recording all possible leases at the beginning of the process, it creates a bigger safety net. That way if anything is missed, it is less likely to be material compared to the recorded lease population. The materiality threshold can then be established based off of the complete (or nearly complete) lease portfolio.

The materiality threshold will impact policy elections, including whether or not to separate lease and non-lease components, as well as the process for working with groups like Procurement to document potential embedded leases.

3

Accuracy and Completeness

Although none of the Big 4 National Policy Offices had published guidance on audit criteria for leasing at the time of the summit, there seemed to be consensus amongst attendees that accuracy and completeness will be the primary focus of year one reviews. With only 45 days remaining to the January 1, 2019 deadline at the time of the summit, many companies were still struggling with achieving completeness for day one and were further concerned about maintaining it on day two and beyond.

Accuracy and Completeness Controls

To ensure completeness, one approach many companies are taking is to send out a quarterly checklist to all stakeholders, including business units like IT, Fleet, and Real Estate around the globe, to request attestations on their leased assets. Another completeness control some companies are instituting is a lease versus buy analysis policy. This has the dual role of ensuring that the organization is choosing the best asset acquisition method and creating an audit trail of all leases the group has signed.

Short-Term vs. Long-Term Controls

Most project teams confessed that they still had a long way to go to finalizing the controls. Many companies had instituted preliminary controls for year one that could be used on an interim basis. However, they also expected to add to or replace those controls as they achieved further automation of their leasing processes.

Documenting Controls

A key focus of project teams has been documenting policies and controls as they're being developed, including explaining the controls, practical expedients, and rationale behind the choices. Documentation can serve as proof to auditors that the organization has developed appropriate controls and can also be used to train new employees. The central group deciding on the controls will also need to work with regional groups to discuss best practices and train local stakeholders.

4

Incremental Borrowing Rate

ASC 842 and IFRS 16 require the use of the discount rate implicit in the lease when present valuing the liabilities. If the rate cannot be determined, the incremental borrowing rate (IBR) should be used. Most leases do not have an implicit rate, so the IBR will be used to present value those obligations. However, there is significant confusion around how to calculate the IBR as the definition has changed somewhat under ASC 842. Companies also need to consider how to handle the IBR at different locations around the world.

Calculating the IBR

Under ASC 842, the IBR should be fully collateralized. For companies that have multiple securitized debt agreements, calculating the IBR will be more straightforward. They can take the data points from their securitized debt agreements and interpolate what the rate should be for the lease depending on the asset and lease term.

However, many companies have limited examples of securitized debt, if any, to draw data from. For these companies, the calculation will be more difficult. Treasury will likely be a major source of information for determining the IBR and may need to take the lead on gathering useful data points. For example, Treasury may utilize the rate for unsecured debt, contact ratings agencies to determine how they calculate the present value of lease obligations, and ask peers in the marketplace that issued securitized debt. Pulling all of those numbers together could provide the base for calculating the final IBRs to be used for leased assets.

Regional Considerations

One of the decisions companies will need to make regarding their IBRs is what rate to use for leases in different regions around the globe. Multi-nationals may hold leases in multiple countries under different currencies, complicating the calculation even further. However, corporations with a centralized treasury function may be able to argue for the use of one IBR globally if they can show that global operations would be funded with the central currency. Alternatively, even companies that cannot make this argument may be able to use one IBR per currency, rather than per country or region. However, these discussions will need to be held with external auditors to get their perspective on what is appropriate regarding the IBR.

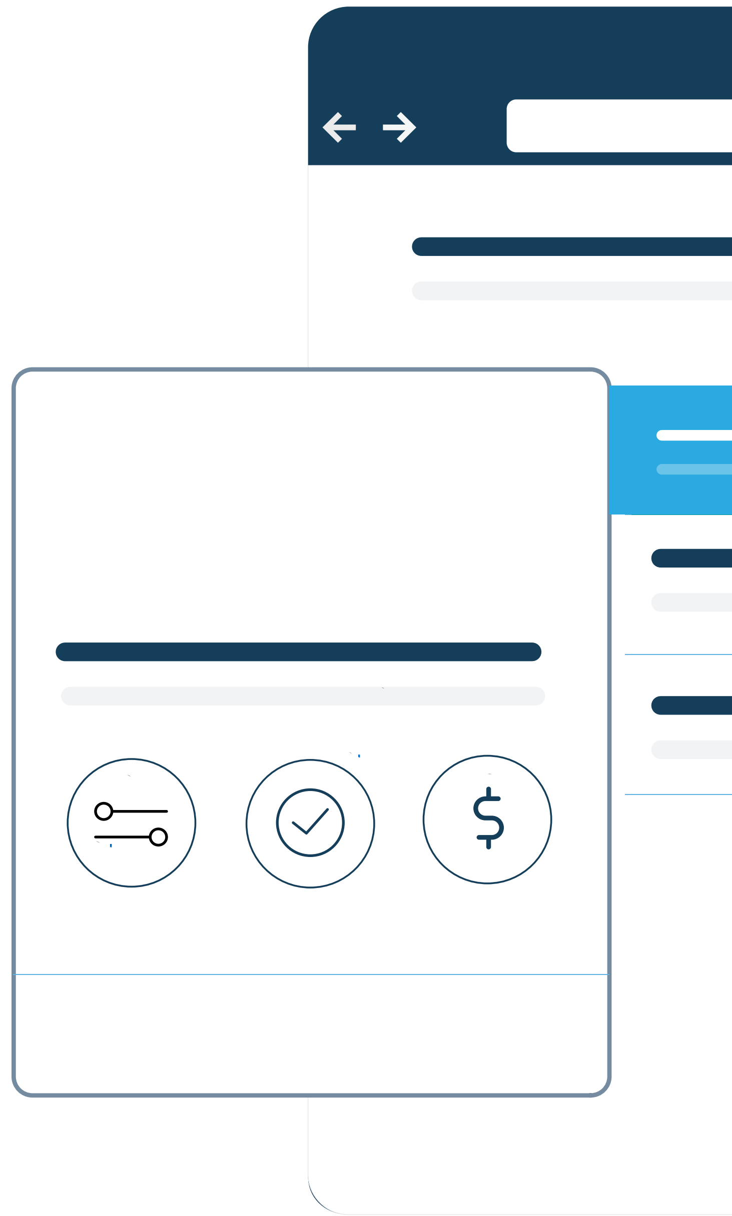
5

Center of Excellence

Many 2018 summit attendees had started to organize post-implementation operations using a “leasing Center of Excellence.” The purpose of these shared service centers is to perform the day-to-day accounting activities in the record-to-report process from booking new leases all the way to end-of-term recordations. At the time of the summit, most companies were in the early stages of recruiting, staffing, and training.

Training is proving to be a key challenge. Employees working in the centers will need to be experts in making judgement calls, such as:

- Whether to classify contracts as operating or finance leases
- Whether contracts meet the definition of a lease
- Determining standalone observable prices for lease components



Roles of Other Business Units

Although Centers of Excellence will handle most of the heavy lifting, some companies are also planning to include a leader from each business unit to act as the lease accounting leader for that group. The leader will work with the central accounting organization to secure training and technical accounting resources. Firms are also working with the individuals responsible for major categories of leased assets. These individuals will have first-hand knowledge of the leased assets, so can help ensure accuracy and completeness of the lease portfolio. However, their involvement in interacting with the leasing system may be limited as that role will likely be more suited to the accounting organization.

Communicating with Business Units

Implementing the lease accounting standards is a truly cross-functional effort because it touches so many parts of the organization. Everyone from Accounting and Treasury to asset users like IT, Fleet, and Real Estate need to be aware of the new standards and trained on their role in maintaining compliance. However, it can be difficult to communicate the importance of keeping lease data up-to-date for the groups that have not traditionally been involved in accounting compliance exercises.

To train the asset users on their role in maintaining compliance with the standard, most organizations are developing training materials and modules. The training covers topics including the lease accounting system, the new standard, and the role of the Center of Excellence. These materials can also be used to train new employees and prove to auditors that there is a system in place to educate stakeholders.

LeaseAccelerator offers the market-leading SaaS solution for Enterprise Lease Accounting, enabling compliance with new FASB and IFRS standards. Using LeaseAccelerator's proprietary asset-based Global Lease Accounting Engine, customers can account for all categories of leases including real estate, fleet, IT, material handling, and other equipment at the asset level.

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